**DEPARTMENT OF CORPORATIONS**
***California's Investment and Financing Authority***

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**Sacramento, California**

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Since the end of last year, the Department of Corporations has collected data from various mortgage loan servicers relating to loan modifications, forbearance plans, and foreclosures. Updated data for the calendar year 2007 was posted previously. The data that accompanies this memorandum is 1st Quarter 2008 data. Please note that there have also been some revisions to data previously posted for January 2008.

Revisions to Previously Posted Data

Three additional servicers submitted data for January, February and March 2008, therefore January data reflects an increase in volumes previously reported. In addition, at least one lender who reported data for 2007 has not reported data for 2008. That lender had no meaningful influence on data regarding modification and foreclosure numbers.

Loan Modifications and Forbearance Plans Have Increased in the First Quarter of 2008

Modifications and forbearance plans are the primary programs designed for borrowers who seek to keep their homes. For the last quarter of 2007, lenders increasingly made loan modifications available to borrowers. The combined number of modifications and forbearance plans has increased in the first quarter of 2008, over levels indicated in the 2007 data previously posted, rising to 12,933 in March 2008.

To minimize the risk a borrower will default after undergoing an initial loan modification, many loan servicers are using re-payment plans for a trial period. In other words, the lender/servicer may agree to a temporary change in mortgage payments to gauge whether the borrowers can make those payments without incident. Assuming the borrower repays for a given length of time, and remains current, the lender/servicer will make this repayment agreement a more sustainable modification, five years or more. Even though the specter of reset shock appears to have subsided as a function of interest rate declines, modifications escalated, especially in March. The increase in modifications parallels the increasing volumes of mortgages resetting, but something different appears to be at work. We understand that increasingly homeowners are experiencing defaults even prior to reset. If true, as it appears to be, we would expect lenders to continue to increase the number of loan modifications and repayment plans made available to borrowers.

With the avoidance of reset shock through lower interest rates, the streamlined modification approach does not address the capacity issue as servicers are now reverting back to loan-by-loan file reviews. Certain servicers are using computer modeling to assist with modification decision-tree analysis. We encourage greater use of such models to speed up file reviews. Housing counselors continue to express frustration at the pace of modifications, and inability to gain access to decision makers at the lenders/servicers. Many such counselors are very experienced and bring forward borrowers who deserve a modification or other relief.

Since January 2008, we have attempted to obtain more granular information on the types of modifications being offered. One such category warrants further explanation. In describing modifications that reduce the interest rate at or below the start rate, lenders have reported modifications where a loan has already adjusted upward, but the modification represents a coverage of the adjusted interest rate back up to the start rate. In other words, the borrowers may have had interest rate adjustments prior to the Governor's agreement, in a higher interest rate environment. When these borrowers cannot make the reset increases, the lenders have reverted the rate back to the initial rate.

Foreclosures Remain a Serious Concern as the Number Continues to Rise

The number of foreclosures in California has increased during the first quarter of 2008. There appear to be at least three principal reasons for this. First is that speculators continue to exit the market and, in light of evaporating appreciation potential, abandon the houses they bought for investment. A second concerns the recognition that some borrowers stretched too far at the outset and could not afford their initial mortgages, either because they took out too large of a loan at refinancing in the hope of further appreciation or expected to refinance after a couple of years but cannot in the current credit environment. In other words, the normal aging process of loans made during a period of poor underwriting standards will yield a higher number of foreclosures.

Third, an increasing numbers of borrowers, especially those who paid very little or nothing down or who refinanced out all their equity, and who live in areas of steep home price declines, have seen appreciation potential evaporate and, instead of working with lenders to modify loans, are walking away from their homes[1]. No precise data exist yet to track this trend, but it has received much media attention, and lenders have expressed sufficient concern to conclude it is real, and not necessarily marginal.

Signs of Success in a Difficult Economy

Despite a coordinated effort by state agencies and cooperation with local jurisdictions and the non-profit sector, the magnitude of the housing downturn is such that even these efforts will have limited impact in dealing with the mortgage crisis. In addition to the state and federal loan modification agreements, critical strategies include counseling and outreach to borrowers to help and encourage them to work with lenders and the expansion of safe and lower cost credit to the California housing market, such as the very welcome recent expansion of federal conforming loan limits to accommodate California housing prices. Nevertheless, **servicers have stated that without these modification agreements there would be even fewer modifications and more foreclosures.** In fact, we have seen increases in the number of modifications being done by virtually all the servicers since the time we began collecting data. But no single step can solve the foreclosure problem.

[1] "Facing Default, Some Walk Out on New Homes," New York Times, February 29, 2008

Efforts to get lenders engaged must increasingly be complemented by efforts to get borrowers engaged, and to keep them engaged in the homeownership process. We continue to be troubled by evidence[2] that borrowers who are actively engaged in addressing credit card and auto loan obligations are not taking similar steps to address mortgage obligations. The State is continuing with outreach efforts that show promise in getting borrowers to meet with housing counselors and lenders, including "***90 Days of Hope***"[3], a public awareness campaign featuring real California families sharing their foreclosure stories and urging others in similar circumstances to call the HOPE hotline for assistance.

Overall, we are encouraged by the trends in the data compiled in the accompanying tables. The data shows that the efforts by the state, by industry and consumer groups are having marked success in mitigating the impacts of the decline in the housing market and in preserving homeownership in difficult times. We will continue to work with lenders and borrowers to preserve homeownership and reduce foreclosures.

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[2] "Experian Subprime Lending Study Shows Consumers Are More Likely to Pay Bankcard Debt Before Mortgage Debt," *Experian Press Release,* 6/20/07

[3] Details of the campaign may be viewed at this link: http://www.yourhome.ca.gov/hope/index.shtml